

FROM: Department of Water Resources

DATE: February 12, 2014

SUBJECT: February 12, 2014 Contract Extension Offer V3 for Extension of the State Water Project¹ Water Supply Contracts

This document contains a proposed Statement of Principles that could provide the foundation for an agreement among the State Water Project Contractors² (Contractors) and the Department of Water Resources (DWR) that will extend the contracts.

Summary To-Date of Contract Extension Negotiation Proposed Offers

May 1, 2013	Contractors' 1st Offer (Initial Offer)
May 1, 2013	DWR's 1st Offer (Initial Offer)
June 26, 2013	Contractors' 2nd Offer
July 10, 2013	DWR's 2nd Offer
August 7, 2013	Contractors' 3rd Offer
September 4, 2013	DWR's 3rd Offer
September 17, 2013	Contractors' 4th Offer
October 2, 2013	DWR's 4th Offer
October 16, 2013	Contractors' 1st Tentative Offer
October 23, 2013	DWR's 1st Tentative Offer
December 17, 2013	Contractors' 5th Offer
January 8, 2014	DWR's Edits to Contractors' 5th Offer
January 15, 2014	Contractors' 6th Offer
January 15, 2014	DWR's Edits to Contractors' 6 th Offer
January 15, 2014	SWP Contractors 7 th Offer
January 22, 2014	DWR's Edits to Contractors' 7 th Offer
January 22, 2014	SWP Contractors 8 th Offer
January 27, 2014	DWR's Edits to Contractors' 8th Offer
January 29, 2014	SWP Contractors 9th Offer
January 29, 2014	1/29 Negotiation Session Offer with Track Changes
February 12, 2014	2/12 Contract Extension Offer with Track Changes V1
February 12, 2014	2/12 Contract Extension Offer with Track Changes V2
February 12, 2014	2/12 Contract Extension Offer with Track Changes V3

¹ The State Water Project is the name commonly used to refer to the State Water Resources Development System (Water Code Section 12931)

² The State Water Project Contractors includes the SWC organization's 27 member public agencies, Butte County Water and Resource Conservation, and Plumas County Flood Control and Water Conservation District.

Outline of Proposed Offer

I.	Objective 1	Term of Contract
II.	Objective 2A	Reserves
III.	Objective 2B	Accounts (SSA, SRA, FCA)
IV.	Objective 2C	Flow of Funds
V.	Objective 2D	Financial Management
VI.	Objective 2E	Supplemental Billing
VII.	Objective 2F	51(e) Revenue Limitations
VIII.	Objective 2G	Reporting Requirements
IX.	Objective 2H	51(e) Revenue Reporting Requirements
X.	Objective 3A	Simplification of Billing
XI.	Objective 3B	RAS
XII.	Objective 3C	1(hh)
XIII.	Objective 3D	Billing Authorization
XIV.	Objective 4	BDCP and DHCCP Participation

STATEMENT OF PRINCIPLES

I. OBJECTIVE 1: TERM OF CONTRACT

A. Water Supply Contract Term Extension

1. Extend term of the SWP water supply contracts by ~~75-40~~ years from December 31, 2035 to December 31, ~~2110~~2075. ~~(Final term pending outcome of Objectives 2, 3, and 4.)~~ (TO BE DISCUSSED)
2. The provisions of the contract extension amendment shall be interpreted and implemented in a manner consistent with the California Water Resources Development Bond Act (Water Code Section 12930 et seq.) and the Central Valley Project Act (Water Code Section 11100 et seq.), to the extent applicable. (TO BE DISCUSSED)

II. OBJECTIVE 2A: RESERVES

A. General Operating Account (GOA)

1. **Uses of GOA** - Cash flow deficiencies resulting from chargeable water supply purposes and/or during a SWRDS emergency for any SWRDS purpose.
2. **SWRDS Emergency** - An immediate, urgent, critical, unexpected, or impending situation that, in the Director's judgment, may cause or pose a risk of causing injury, loss of life, damage to the property, impairment of the financial condition, and/or interference with the

- normal activities of the State Water Resources Development System which requires immediate attention and remedial action.
3. **Initial Cap** - Increase the authorized General Operating Account (GOA) balance from \$22.7 million to \$150 million pursuant to Article 51(a)(3).
 4. **Cap Adjustment Determination** - Every five years there shall be a business case analysis on the GOA authorized cap including an evaluation of the cap and business risks associated with SWRDS cash flow provided to the SWRDS Finance Committee for recommendation to the DWR Director regarding a GOA cap adjustment. If there is a decrease in the cap (but the cap shall not be lower than \$150 million), the excess funds would be transferred to the SRA.
 5. **Cap Adjustment Funding Source (Pre-2035)** - Shall be the Director's discretion to use 51(e) revenues, investment earnings retained in the GOA, and transfers of funds from the SRA and SSA.
 6. **Cap Adjustment Funding Source (Post-2035)** - Shall be the Director's discretion to use the investment earnings retained in GOA and the funds within the SRA and SSA.
 7. **Rate of Funding for Cap** - Limitation on the amount (\$2 million per year) and timing of additional contributions to the GOA contained in Article 51(e)(3)(v) will be deleted. DWR will be able to use any amount of available 51(e) revenues to increase funds in the GOA up to the authorized maximum GOA funding level and such funding shall be subordinate to the annual rate management reductions to the water contractors.
 8. **GOA Replenishment** - Replenishment of the use of GOA funds will come from charges to the water contractors to the extent the expended funds were spent on chargeable water supply purposes and from the SSA or other available revenues for costs not chargeable to the Contractors. (TO BE DISCUSSED)
 9. **GOA Reporting** - DWR will prepare monthly reports on the balance and use of the GOA for the Director, which will be provided to the SWRDS Finance Committee. The SWRDS Finance Committee will periodically review reporting frequency and make recommendations to the Director regarding reporting frequency.
 10. **GOA Investment Earnings** - shall be used as follows:
 - a) Funding GOA to authorized GOA funding level;
 - b) Transferred, at the discretion of the Director, to the SWRDS Support Account (SSA) and/or to the SWRDS Reinvestment Account (SRA).

III. OBJECTIVE 2B: ACCOUNTS (SSA, SRA, FCA)

A. SWRDS Reinvestment Account (SRA)

1. **Effective Date of SRA** - The SRA shall be established and take effect upon the effective date of the contract extension amendment.
2. **SRA Uses** - The primary purpose is to provide a post-2035 SWRDS revenue stream by investing SRA funds in SWRDS facilities and programs.
3. **Funding Source** - At the discretion of the Director, available Article 51(e)(1)(ii) revenues collected by the State pre-2035. The Director also has discretion to transfer funds from the SSA or the GOA.
4. **Cap on SRA** - There will be no Cap or Cap Adjustments to the SRA.
5. **SRA Investments** - At the discretion of the Director, authorized SRA investments shall be as follows:
 - a) Investment in SWRDS capital facilities, recovered at the prevailing municipal bond market rates corresponding to the SWRDS bond rating at the time of financing, in maturity ranges that may extend 10 to 50 years;
 - b) Bridge financing of capital costs in lieu of the SWRDS commercial paper program; and
 - c) Allowable investments for SWRDS that generate a monetary return on investment.
6. **Use of SRA Funds** - At the discretion of the Director, the SRA funds, including but not limited to investment earnings, shall be used to:
 - a) Provide a source of replenishment funds to the SSA;
 - b) Provide a source of funds to be held in the SRA for investment purposes; and
 - c) Provide a funding source for funding level adjustments to the GOA.
7. **SRA Review** - The SWRDS Finance Committee is to be consulted about the investments and activities to be funded from the SRA.
8. **SRA Reporting** - DWR will prepare regular reports on the SRA for the Director, which reports will be provided to the SWRDS Finance Committee.

B. SWRDS Support Account (SSA)

1. **Effective Date of SSA** - The SSA shall be established and take effect upon the effective date of the contract extension amendment.
2. **SSA Uses** - The purpose of the SSA shall be to provide a source of funds to pay for non-chargeable expenditures where there are no funds or revenue sources available to pay for such costs. If reimbursement or a source of revenue is received after the expenditure is incurred this revenue shall be deposited in the SSA.
3. **SSA Review** - The SWRDS Finance Committee shall be consulted about the projects and activities to be funded from the SSA.
4. **SSA Reporting** - DWR will prepare regular reports on the SSA for the Director, which will be provided to the SWRDS Finance Committee.
5. **Initial Cap** - There would be no cap on the SSA.
6. **Funding Source for Initial Funding** - 51(e) revenues and/or the remaining balance of the Facilities Capital Account (FCA) once the FCA is closed.
7. **SSA Replenishment** - Shall be accomplished through 1) reimbursements received for expenditures made from the SSA; 2) at the discretion of the Director, transfers from the SRA and/or from the GOA's available investment earnings, 3) deposits, in the discretion of the Director, from other available revenues, and 4) interest and other investment income retained in the SSA. DWR will not charge the Contractors to replenish the SSA for costs not chargeable to the Contractors under the Water Supply Contracts. (TO BE DISCUSSED).
8. **SSA Interest Earnings** – At the Director’s discretion, retained in the SSA to reduce the annual SRA replenishment requirement.

9. **SSA Backstop: (TO BE DISCUSSED)**

C. State Water Facilities Capital Account (FCA)

1. The State Water Facilities Capital Account (FCA) pursuant to Article 51(c)(2)(v) shall be reviewed by the SWRDS Finance Committee after five years from the date of the contract amendment to recommend to the Director whether or not it should be closed and the balance of the account transferred to the State Water Resources Development Support Account (SSA).

IV. OBJECTIVE 2C: FLOW OF FUNDS**A. Maintain the Monterey Amendment Article 51 Flow of Funds with the following edits/additions:**

1. Increase Annual Rate Reductions to \$48 million. The Annual Rate Reductions shall no longer apply after December 31, 2035 and the applicable provisions in Article 51 shall be deleted as of that date.

2. ~~In the year of determination, following the \$48 million in annual rate reductions, the Director shall have the discretion to allocate and transfer up to 80% of the estimated balance of 51(3) revenues into one or more of the following three accounts~~ After the annual \$48 million in annual rate reductions, the Director shall have the discretion to allocate and transfer up to 80% of remaining available 51(e) revenues, as determined on a projected basis, and up to 100% as determined on an actual basis, from the preceding two calendar years and redetermined annually, into one or more of the following accounts:

- a) General Operating Account (GOA)
- b) SWRDS Support Account (SSA)
- c) SWRDS Reinvestment Account (SRA)

After funds are deposited into accounts a, b, and c above, any remaining available 51(e) revenues will remain in the Systems Revenue Account and will be tracked separately in DWR's Enterprise Resource Planning (ERP) system. The Director will have full discretion over the use of these funds. DWR will prepare financial reports annually with supporting documentation of the determination and provide these reports to the Finance Committee.

3. Contractors shall agree to forego additional rate management reductions including additional rate management reductions to make up for deficiencies in past projected rate management reductions or to provide any additional rate management reductions above \$48 million annually pursuant to Article 51(e)(3). Effective with the contract amendment, Article 51(e)(3) shall be deleted.
4. The contract amendment shall specify those provisions in Article 51 that shall remain in effect after December 31, 2035 (such as the General Operating Account provision as it may be amended) and those provisions that will no longer apply after December 31, 2035 which shall be deleted as of that date.
5. Contractors shall agree to waive and release other issues related to DWR's recent adjustment of the water contractors' responsibility for facilities south of Dos Amigos.

V. OBJECTIVE 2D: FINANCIAL MANAGEMENT

A. State Water Resources Development System Finance Committee

1. Immediately, the Department of Water Resources shall establish a joint Department of Water Resources and Contractor finance committee (Committee).
2. The membership of the Committee shall include both representatives from the Department of Water Resources and representatives from the contractors.
3. The primary purpose of the Committee shall be to make recommendations to the Director of the Department of Water Resources concerning the financial policies of the State Water Resources Development System.
4. The Department of Water Resources and the Contractors shall describe the scope of the committee in a charter mutually agreeable to the Department of Water Resources and the Contractors.

VI. OBJECTIVE 2E: SUPPLEMENTAL BILLING

A. Supplemental Billing

1. The supplemental billing provisions authorized under Article 51(c)(4) shall remain in effect through December 31, 2035, unless the Director determines in his or her discretion to eliminate the use of supplemental billing prior to that date or upon Director's acceptance of a recommendation from the SWRDS Finance Committee. In full consultation with the SWRDS Finance Committee, DWR will review the System cash balances when the System's 120 days cash balance becomes critical. The Committee will make a recommendation for action to the Director. The supplemental billing provision may only be used when available System cash balances are projected to be less than an amount equal to 90 days operating expenditures.

VII. OBJECTIVE 2F: 51(e) REVENUE LIMITATIONS

~~DWR shall not use 51(e) Revenues to pay for reimbursable water supply costs in-lieu of seeking reimbursement from Contractors without Contractor approval.~~

DWR shall not use 51(e) Revenues to pay for reimbursable water supply costs in-lieu of seeking reimbursement without Contractor approval. (TO BE DISCUSSED)

VIII. OBJECTIVE 2G: REPORTING REQUIREMENTS

See separate Reporting document.

IX. OBJECTIVE 2H: 51(e) REVENUE REPORTING REQUIREMENTS

Contractors will provide more detail at the next meeting.

X. OBJECTIVE 3A: SIMPLIFICATION OF BILLING

A. Implement the Freeze-Go Billing Methodology

1. Methodology will freeze all costs incurred prior to January 1, 2016, and continue repayment consistent with current contract terms.
2. Methodology will recover all costs incurred after December 31, 2015, by converting and authorizing repayment on a Pay-As-You-Go methodology.
3. Amend the definition of the Project Repayment Period to apply only to those costs incurred prior to January 1, 2016.
4. The term of the Project Repayment Period, January 1, 1961 through December 31, 2035, will remain the same.
5. The Water Systems Revenue Bond Surcharge will apply only to those costs incurred prior to January 1, 2016 and will terminate at the completion of the Project Repayment Period.
6. Amend the definition of the Project Interest Rate to apply only to those costs incurred prior to January 1, 2016. The Project Interest Rate will remain 4.610%.

B. Defining the Pay-As-You-Go Repayment of Costs Incurred Post-2015

1. The annual cost recovery within a bill year for estimated annual operation, maintenance, power, and replacement costs for project conservation facilities.
2. The annual recovery of actual debt service, including repayment of the SRA, created by SWRDS financing activities, within a bill year for financed capital transportation and conservation facilities.

C. Defining the Pay-As-You-Go Repayment of Actual Debt Service from SWRDS Financing Post-2015 Capital Costs

1. Authorize SWRDS to finance 100% of all capital costs.
2. Authorize SWRDS to use various methods of financing including Water System Revenue Bonds and SRA, with each method providing an annual repayment schedule which includes a principal and interest (debt service) component over the life of the financing.
3. Authorize SWRDS to bill an amount that is equal to the accumulated annual debt service payments due per the debt service schedules for SRA investments or matching dollar for dollar the SWRDS annual debt service payments including the bond cover requirements,

providing 100% capital cost recovery at the financed interest rate over the term of the financing while meeting the additional bond debt cover requirements.

XI. OBJECTIVE 3B: REPLACEMENT ACCOUNTING SYSTEM (RAS)

A. Elimination of the Replacement Accounting System (RAS)

1. Eliminate the Replacement Accounting System (RAS) for Transportation and Conservation Facilities with the intent to have replacement costs treated as a minimum or capital cost.
2. The unencumbered cash balance of the RAS funds are to be returned to the SWP Contractors using the RAS allocation methodology.

XII. OBJECTIVE 3C: ARTICLE 1 (hh)

A. Expanding Water System Facilities Authorized to be Financed by Water System Revenue Bonds Under Article 1(hh)

1. Eliminate the January 1, 1987 date for existing facilities within Article 1(hh)(8); provision to now read as follows, " Finance all repairs, additions, and betterments to conservation or transportation facilities and to all other facilities described in this sub-article (hh) except for item (5) the land acquisition prior to December 31, 1995 for the Kern Fan Element of the Kern Water Bank."
2. Add provision to Expand 1(hh) to include "Finance all other capital projects (i.e. projects and programs for which revenue bonds can be sold) mutually agreed upon in writing by DWR and 80% of the affected Contractors, provided that the approving Contractors' Table A amounts exceed 80% of the Table A amounts representing all affected Contractors".
"Affected Contractors" mean those contractors which would be obligated to pay a share of the debt service for such project.

XIII. OBJECTIVE 3D: BILLING AUTHORIZATION

It is recognized, there shall be incorporated in the planning, construction of the State Water Project those features that the department, after giving full consideration to any recommendations which may be made by the Department of Fish and Wildlife, the Department of Parks and Recreation, any federal agency, and any local governmental agency with jurisdiction over the area involved necessary or desirable to permit, on a year-round basis, full utilization of the project for the enhancement of fish and wildlife and for recreational purposes to the extent that those features are consistent with other uses of the project.

Such recreational purposes include, but are not limited to, those recreational pursuits generally associated with the out-of-doors, such as camping, picnicking, fishing, hunting, water contact sports, boating, and sightseeing, and the associated facilities of campgrounds, picnic areas,

water and sanitary facilities, parking areas, viewpoints, boat launching ramps, and any others necessary to make project land and water areas available for use by the public.

Costs incurred for the development of public recreation and the enhancement of fish and wildlife shall not be included in the prices, rates, and charges for water and power, and shall be costs that are not reimbursable by the contractors.

XIV. OBJECTIVE 4: BDCP AND DHCCP PARTICIPATION

The Department and some State Water Project contractors are directly participating in the development of the Bay Delta Conservation Plan (BDCP) and the associated Delta Habitat Conservation and Conveyance Plan (DHCCP). The details of the financing and repayment, specifically how the Department will charge each SWP contractor for future costs for implementation of the BDCP and DHCCP, has not been determined. Each contractor's participation in the implementation and financing of the BDCP and DHCCP should be voluntary. The Agreement in Principle and subsequent contract amendments should limit each contractor's obligation to fund any implementing and related BDCP and DHCCP projects to only those contractors that agree to participate in those projects. Butte and Plumas shall not be responsible for any costs incurred by the Department for the BDCP and DHCCP unless each of them agrees to pay for such costs in the Agreement in Principle and subsequent contract amendments to the Statement of Charges. (Currently under review by State Water Project Contractors. [TO BE DISCUSSED])